

Department of Economics 2011 summer

ECO358H1F
Financial Economics I
Section L0101
University of Toronto
Department of Economics

Course Location and Time: MS2173, Tuesdays and Thursdays 17:00-20:00.
Instructor: Ling Sun
Office Location: Economics Department, Max Gluskin House, Room 229
Email Address: ling.sun@utoronto.ca
Office Hours: Tuesdays and Thursdays 16:00-17:00 or by appointment
Website: Blackboard

Prerequisite: ECO200Y/204Y/206Y, ECO220Y/227Y/STA (247H, 248H)/ (250H, 255H)/ (257H, 261H)
Exclusion: ACT349H1, MGT331Y1, 337Y1, RSM332H, 333H

Prerequisites are strictly checked and enforced and must be completed before taking a course. By taking this course you acknowledge that you will be removed from the course at anytime if you do not meet all requirements set by the Department of Economics. For further information you can consult the University of Toronto Faculty of Arts and Science 2011-2012 Academic Calendar, which is available from the Registrars' Office.

Course Description

The aim of this course is to give you an overview of the major theories, tools and results in Portfolio Theory and Asset Pricing. During class, some institutional perspectives of financial markets are introduced, and the theoretical concept and applicable tools are emphasized. Topics to be covered include valuation of fixed income securities, expected utility and portfolio choice, the major models of asset pricing (CAPM, APT), efficient capital market, and option pricing theory. As time is limited, we will mainly discuss theoretical issues, but we will also apply the ideas to understand some real-world examples.

Textbooks and Other References

The main textbook for the course is *Investments, 7th Canadian Edition* by Bodie, Kane, Marcus, Perrakis and Ryan (2008, McGraw-Hill Ryerson, hereafter referred to as BKMPR). Students who purchase this book will have access to an on-line learning centre maintained to supplement it. Two other references are recommended: one is *Financial Theory and Corporate Policy, 4th Edition* by Copeland, Weston and Shastri (2005, Pearson Addison Wesley, hereafter referred to as CWS), the other is *Corporate Finance, 5th Canadian Edition* by Ross, Westerfield, Jaffe and Roberts (2008, McGraw-Hill Ryerson, hereafter referred to as RWJR).

Exams

There are two midterm exams. Both midterms are two hours long and will be written during class. The first Midterm will take place on May 31, 2010 at EX300; the second will take place on June 16, 2010 at EX300. The final is a three-hour exam.

Grade Composition

There will be three exams, two midterms and a final. Your course-grade is composed as follows:

$$\begin{aligned} & 40\% \times \text{final} \\ & + 30\% \times \max \{\text{midterm I, midterm II}\} \\ & + 30\% \times \max \{\text{final, min}\{\text{midterm I, midterm II}\}\}. \end{aligned}$$

subject to the provision that the max rule applies only if you achieve a grade of at least 30% in both midterm exams. If you do achieve a grade below 30% in either of the midterms, then both midterm marks count for 30%. This implies in particular that you cannot discard one of the midterm exams by submitting an empty exam script. As such, your final counts at least 40%; your better midterm counts 30%, and your worse midterm counts 30% only if it is better than the final. In other words, you can pass the weight of your worst midterm to the final, but one midterm will count.

There are no “make-up” tests.

Procedures and Rules

Missing a Midterm. The Midterms are compulsory. If you miss a midterm, their 30% weight in the course grade will only be shifted towards the final if you have a legitimate medical excuse as outlined in the university policies.

In the event a student misses midterm test due to illness or domestic tragedy, the student must submit a doctor’s note or the university’s official “Student Medical Certificate” (available online at <http://www.healthservice.utoronto.ca/pdfs/medcert.htm>) indicating the type of illness and date of illness (or other applicable documentation for domestic situation) within *48 hours of the test date*.

Re-grading. If you appeal to re-grade one or more questions on the midterm test, you have to request in writing and outline in detail why you think that you deserve a higher mark. Your TA will re-grade the entire problem set/exam. Note that this may lead to a lower overall grade.

Email Communication. I will use the email system frequently to send out material, such as announcements about office hours etc. I will use Blackboard to compile the email distribution list from your entries in ROSI. It is thus imperative that you update your email-address on ROSI ASAP. Please check also the Blackboard system frequently for up-to-date information.

I will reply to legitimate email inquiries from students within two working days. If you do not receive a reply within this period, resubmit your question(s). I will NOT answer emails in the last **36 hours** before

a test. Please note that some email servers (such as hotmail) can be unreliable in both sending and receiving messages. Students must make sure that their messages do not include language or logos or reply email addresses that may be offensive. Each email message must include in the “subject” the course number (ECO358H1F) and a concise and clear statement of purpose — otherwise it will be deleted, along with spam messages, financial scam letters and messages potentially containing viruses. In the first few weeks of class, please include your full name and your student number in your message.

Where a question cannot easily or briefly be answered with a reply email, I will simply indicate to the student that s/he should see me during the announced office hours. I will not explain concepts or the like via email, not matter the circumstances.

TA Support. Your TA is Ding Ding. Her email address is d.ding@utoronto.ca. She will hold office hour on Wednesdays from 10 am to noon. She will also hold tutorials before the midterm tests and the final exam.

Tentative Course Structure

Class 1: (May 17) Basics of financial markets (BKMPR Ch. 1-4 & lecture notes).

Class 2: (May 19) The time value of money (RWJR Ch. 4, 5, CW Ch. 1, 2, & lecture notes).

Class 3: (May 24) Bond pricing; the term structure of interest rates. (BKMPR Ch. 2 and 13-14 & Lecture notes). Dividend discount model. (RWJR Ch 6).

Class 4: (May 26) Choice under uncertainty, portfolio theory I (BKMPR Ch. 6, & lecture notes).

Class 5: (May 31) Midterm 1.

Class 6: (Jun 2) Portfolio theory II (BKMPR Ch. 7 & lecture notes).

Class 7: (Jun 7) CAPM (BKMPR Ch. 8).

Class 8: (June 9) Basics of general equilibrium theory, no-arbitrage, the law of one price (lecture notes).

Class 9: (June 14) Single and multi-factor models. Arbitrage pricing theory (BKMPR Ch. 9 & lecture notes).

Class 10: (June 16) Midterm 2.

Class 11: (June 21) Empirical evidence of market returns. Market efficiency. (BKMPR Ch. 10 and lecture notes).

Class 12: (June 23) Option pricing (BKMPR Ch. 18 & 19 and lecture notes).